Ironbark Karara Australian Share Fund

BENCHMARK
S&P/ASX 300 Accumulation Index

OBJECTIVE
To outperform the benchmark (before fees) over rolling 4-year periods.

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INCEPTION DATE	30 June 2005	**MANAGER APPOINTED**	1 May 2010
MANAGEMENT FEE	0.9225% p.a.	**FUND SIZE**	$17.9m
BUY / SELL SPREAD	+0.20% / -0.20%	**EXIT PRICE**	$1.6127

Net performance (%)

	1 month	3 months	1 year	3 years p.a.	5 years p.a.	7 years p.a.	10 years p.a.	Since inception p.a.[3]
Fund[1]	**-0.32**	**13.13**	**-4.64**	**2.82**	**6.30**	**4.39**	**6.20**	**6.07**
Benchmark[2]	1.32	13.79	1.73	6.87	8.84	7.45	7.75	7.36
Active	*-1.64*	*-0.66*	*-6.37*	*-4.05*	*-2.54*	*-3.06*	*-1.55*	*-1.29*

Top 5 monthly contributors and detractors

Contributing stocks	Active position
CSL	Underweight
BHP Group	Overweight
Rio Tinto	Overweight
Cochlear	Underweight
a2 Milk Company	Underweight

Detracting stocks	Active position
QBE Insurance Group	Overweight
Qantas Airways	Overweight
Fortescue Metals Group	Underweight
Afterpay	Underweight
Telstra Corporation	Overweight

Top 5 quarterly contributors and detractors

Contributing stocks	Active position
CSL	Underweight
Oil Search	Overweight
Newcrest Mining	Underweight
Qantas Airways	Overweight
Virgin Money UK	Overweight

Detracting stocks	Active position
Commonwealth Bank of Australia	Underweight
Fortescue Metals Group	Underweight
QBE Insurance Group	Overweight
Afterpay	Underweight
Brambles	Overweight

Top 5 active weights

Stocks	Active position
CSL	Underweight
Commonwealth Bank of Australia	Underweight
Qantas Airways	Overweight
Telstra Corporation	Overweight
Downer EDI	Overweight

Market capitalisation (%)

Market cap	Fund	Benchmark
1-50	69.33	73.83
51-100	16.74	13.54
101-200	7.56	9.08
201-300	3.01	3.55
Ex-300[4]	1.83	0.00
Cash	1.53	0.00

Past performance is not indicative of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Returns are rounded to two decimal places. Slight variations to actual calculations may occur.

[1] Karara Capital was appointed investment manager on 1 May 2010. Fund performance prior to this date is not attributable to Karara Capital but the prior manager.

[2] The S&P/ASX 300 Accumulation Index was adopted as the Fund's performance benchmark on 1 July 2010. Benchmark calculations prior to this date are based on the S&P/ASX All Ordinaries Index.

[3] This figure represents the annualised performance of the Fund since inception.

[4] Includes placement securities.

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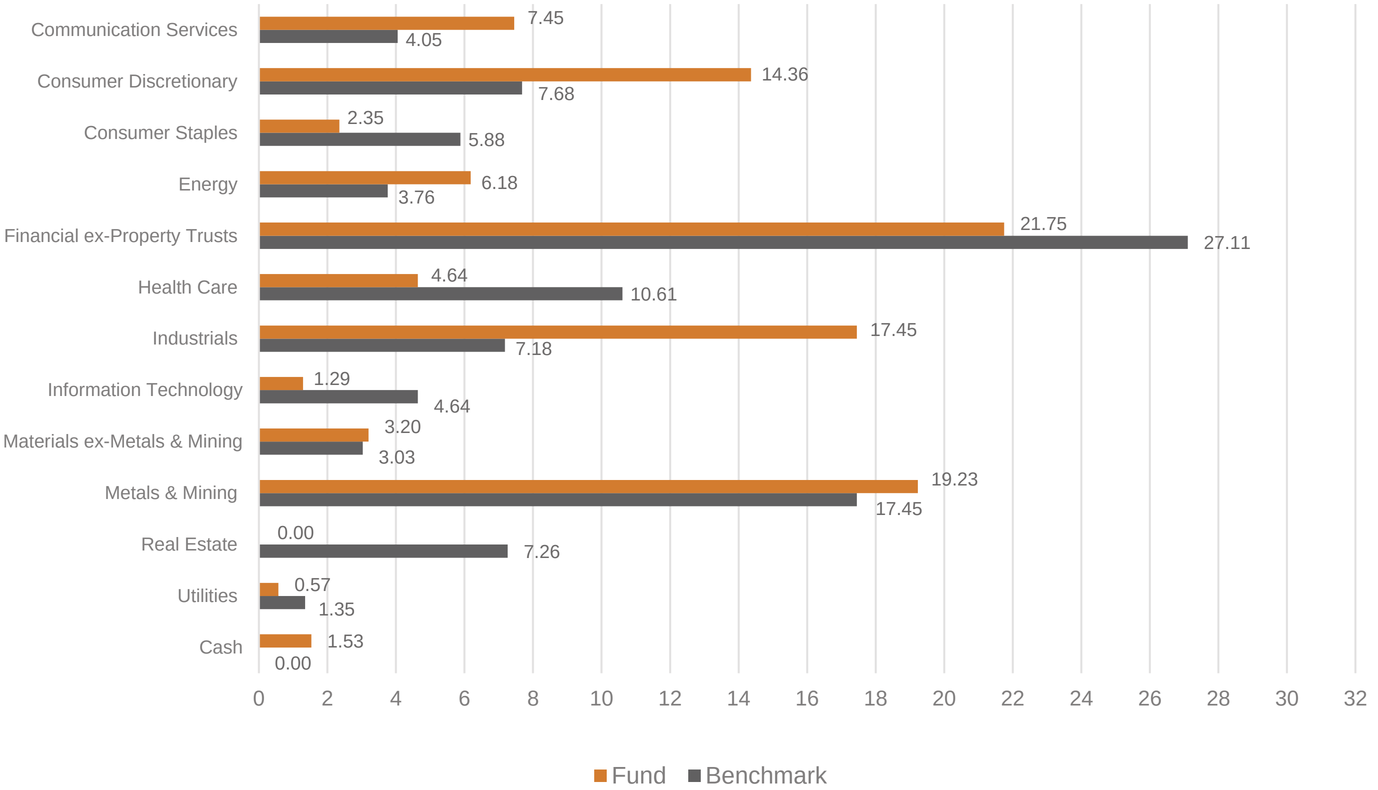
Sector asset allocation (%)



Market review

At a high level everything went right. Benchmark heavy sectors such as miners and banks reacted strongly to the recovery narrative in Australia and in China. The digital disruption thematic continued to explode technology sector valuations higher, supported by the pandemic demand boost and a range of central bank reinforcements that global liquidity creation will be ongoing. COVID 19 impacted sectors bounced sharply following the fast fade of the Victorian outbreak and then the vaccine trial success shortly after. Finally, markets globally were enthused by the US election result which signals more predictable and rational policy and continuing stimulus. This triggered inflows into risk assets, notably emerging markets, NASDAQ and technology, crypto currencies, and away from the US dollar, longer duration fixed income, gold and cash.

Most of the gain came via a 10.2% surge in November as the two large tail risks, the US elections and COVID 19, were cleared emphatically. These had weighed on markets in October, but the market took off after the US elections and vaccine trial success released pent up investor anxiety. There was additional support for the ASX from the Reserve Bank of Australia announcement of quantitative easing and a highly tolerative approach to maintaining support, economic data which showed the economy was recovered faster and from a higher base, and a leap in commodity prices.

The extraordinary success of each of the three leading COVID 19 vaccine trials surpassed all expectations. This converted the best-case outlook for the pandemic, normal life effectively resuming for most developed world citizens by the mid-2021, to the base case almost overnight. Optimism that the reopening of domestic borders would be permanent was proven misplaced with the hotspots in NSW and then Victoria re-emerging at year end.

Bond yields rose modestly with the yield on Australian 10 year government bonds rising 0.18% to 0.97%. The rise in US yields was largely comparable with US 10 year government bond yields increasing 0.25% to 0.93%. Despite real rates remaining close to their lows, a weak US dollar (USD) and booming price of crypto currencies, gold struggled 5% pressured by record redemptions from gold ETFs.

The leap in commodity prices is aiding the Australian fiscal position with the strength in iron ore continued unabated with it finishing the quarter at $162 per tonne (in USD terms), a 35% increase and double the low of the March quarter. Brent oil rebounded 22% as the outlook for demand improved with the vaccine and ongoing OPEC supply discipline continues to manage the short-term demand drop.

Market review (continued)

The index ended the quarter only marginally shy of its all-time high set in February. While massive in absolute terms, the ASX's performance was unremarkable relative to most developed markets but at the upper end of returns when adjusted for the 7.4% rise in the Australian dollar. Emerging markets did better still, with US dollar weakness (DXY down 4%) driving 20% gains from many.

Earnings estimates continued to track higher and the breadth of upgrades was at its greatest in five years. The extent of the market move suggests the investors now view earnings growth for next year as too conservative, particularly amongst the COVID 19 recovery plays.

The dynamic of urgent recapitalisations and lower dividends seen in the March and June quarters exhausted itself. This was supplanted by a stream of local merger and acquisition related activity which was focused on a variety of recent under-performers. Equity supply has moved towards small cap IPOs and indications are that a new phase has initiated with a range of opportunistic trade and private equity bids emerging. This suggests that buyers have had time to review the new disclosures, access funding and gain sufficient confidence in the outlook. Common factors appear to be remarkably low funding costs relative to the target's free cashflow yield, disaffected or frustrated shareholder bases, longer term investment horizons and a willingness to work with profitable but lower growth businesses, as opposed to major in-market synergy. The exception to this was the announced merger of gold producers Saracen and Northern Star which was structured as a genuine combination of equals with considerable value to be created from infrastructure sharing and cost efficiencies.

Performance review

The Ironbark Karara Australian Share Fund returned 13.13% (net) for the quarter, an underperformance of 0.66% when compared with the S&P/ASX 300 Accumulation Index return of 13.79% for the quarter.

Although the timing has been uncertain, the Fund has been positioned for the pandemic re-opening trade. This reflected the view on the likelihood of improvement and, by any historical measure, the extreme valuations differentials. This was a major factor supporting fund performance over the quarter.

Health care, which the fund is significantly underweight, was the second worst performing sector (down 4.7%). This added 0.91%, predominantly through CSL which fell 1.3%. The sector was pressured by the strong currency, uncertainty around short term earnings from COVID 19 (both up and down), as well as rotation as investors covered bank shorts, jumped into tech and a few other niche sectors which seem to have stolen its thematic mantle. More broadly this could be characterised as broadening market earnings growth conflicting with high expectations and higher valuations.

Qantas (up 19.8%), along with Star Entertainment (up 20.3%) and Sydney Airport (up 9.4%) saw belated appreciation that domestic travel will rebound strongly. Positions in each of these were trimmed in November following strong gains. These lost steam in December with renews border closures. At below $5 a share, Qantas is pricing little for future international profitability, lowered costs and enlarged domestic market share. The investment manager expects Star can be re-rated for strong cost and cash performance not to mention its governance edge over Crown, which may create opportunities down the track.

These gains were partly offset by the continuing gains in tech and disruptive thematic plays, which are adding billions of dollar of market capitalisation seemingly by the month. Afterpay (up 47.5%) alone detracted 0.34% and Xero (up 45.7%) another 0.31%. As a generalisation these stocks are being judged on short term metrics without context to the implied terminal market size, share and profitability. This leaves them highly vulnerable to any rise in interest rates, tightening in liquidity conditions or stock specific setback.

Corporate activity and restructuring moves continued to simmer. Tabcorp (up 16.8%) rallied on press speculation that private equity was considering a take-private transaction. Telstra (up 7%) lagged despite setting out plans to monetise its mobile network towers and re-committed to improvement in mobile margins in the second half. Both companies have better growth, good potential for the removal in industry pressure points, and further restructuring upside when lined up against domestically oriented yield plays. Consequently, the investment manager sees their share price improvements as only reflecting part of the potential.

Brambles (up 1%) and Aristocrat (up 3.8%) lagged despite upgrades to market estimates. Aristocrat's accounting was aggressively conservative. The declining Brambles share price assumes any uncertainty will be resolved to the negative and so surprised when guidance was tightened to the upside.

Small cap positions within the Fund detracted approximately 0.80%.

QBE's downgrade was particularly disappointing given the investment manager's expectation that COVID 19 related losses were sufficiently provisioned for. The company was caught by a historically large number of hurricane losses which got beneath their reinsurance cover. Importantly for the investment manager's investment view, capital position remains solid enough and small attractional losses are to budget and ongoing extremely high premium rate increases suggest underlying earnings of the business should be lifting should normal conditions ever eventuate. The investment manager expects portfolio rationalisation to be high on the agenda of a new CEO, which may provide a catalyst to close the discount to peers.

Mining and metals exposures were largely a wash (overweight BHP, Rio and Saracen/Northern Star but underweight Fortescue, IGO and Oz Minerals) although energy companies made a good contribution.

The Fund added to overweight positions in NAB, Telstra and Transurban.

Market outlook

The approval of multiple vaccines foreshadows the resolution of the health crisis should allow a sustainable economic reopening in most of the developed world by mid-2021. Despite inevitable logistical hiccups in their rollout, as the growth sapping and distortive lockdown measures are unwound the global economic recovery should gain pace in 2021. As vaccination programs accelerate this should help markets to work through the near-term resurgence of the COVID 19 virus and its impact on short term economic activity.

COVID 19 has rewritten the rules of public policy with fiscal and monetary policies now effectively co-joined. This will have consequences that will endure beyond the pandemic. Interest rates will remain suppressed by central banks while governments (and voters) no longer seem fussed by government budget constraints. The investment manager expects policy support will continue to underwrite economic activity, but this will come with implications for inflation and economic growth.

The investment manager is seeing evidence of upward price pressure in a several industries (and commodities) already, driven by precautionary inventory building, rebounding demand which are outstripping the ability to supply. This is still beyond the market's horizon with price pressures well within central bank's higher tolerances and while large quantities of fresh liquidity continuing to be added. This continues to bode well for hard assets relative to financials with strong growth in the monetary base and low interest rates impacting on financial margins.

The US Federal Reserve has rejected yield curve control, and so it is hard to imagine nominal interest rates staying as low as the market currently expects. The investment manager expects forward rates eventually adjust higher once the cyclical upturn broadens, the output gap narrows and the level of incremental liquidity injected is pared back. As economies recover the reflation trade should build and shorter duration assets (value) should do better relative to longer ones (growth) supported by a rebound in corporate profits, especially in industries where demand has been suppressed.

While the backdrop is supportive of equities, particularly relative to bonds, the sharp recovery in equity markets is feeding increased and broadening speculation. In the investment manager's assessment, this has resulted in prices that are far beyond any likely improvement in fundamentals for most of the current market favourites. Further, aggregate industrial company valuations are at heights that have been seen very rarely, and from which extended bear markets have always followed.

For many companies that have far surpassed pre-COVID 19 highs, global markets anticipate the step-change in digital migration will be sustained and extended. In some instances, this may turn out to be warranted. But locally there are few plays that have the sustainable competitive advantage that has enabled the FAANG (Facebook, Amazon, Apple, Netflix, Google) phenomenon seen in the US.

Just as in 1999, there a wide and dangerous consensus has built that valuations in some areas are impossible to square with fundamentals, but also that it has further to run. This is drawing in fresh investors in search of quick returns but also a valuation dispersion of historically epic proportions.

The emergence of some corporate activity among the value sector in the December quarter, the investment manager thinks, is a broader manifestation of investor impatience with lower growth companies in a difficult operating environment. An arbitrage has opened in earnings yields versus the cost of money for corporates, activist investors, or financial sponsors. Although the Fund has seen some small benefit from this so far, the investment manager sees this as a matter of time if management are not able to aggressively address under valuation directly.

Despite the re-emergence of hotspots in December, Australia it is better positioned than most developed countries in the medium term. Unemployment has not reached the peaks expected, stimulus is fuelling a recovery and house prices are recovering strongly. The outlook is underpinned by relatively low levels of public debt, strength of its commodity income base, and inbound migration, which will likely return in due course as the fundamental attraction to live here has likely only been strengthened as a result of its handling of the pandemic.

The Fund remains positioned for normalisation of activity globally and holds a range of companies that have yet to price a proper recovery despite strong performance through the shutdowns, lowered costs and stronger balance sheets. Included in this category are a range of COVID 19 impacted stocks that provide a levered play on value. The investment manager has also been increasing positions in a range of defensive stocks not exposed to digital disruption, but with what they perceive as large fundamental mispricing. Finally, there is a category of companies where the durability of profits and business models has only been reaffirmed by the snap recession, which investors continue to either ignore or have low interest in versus growth and momentum. This leaves the Fund, the investment manager believes, holding tremendous relative value within the context of elevated market valuations.

Despite the market rebound and risks noted above, the investment manager still sees opportunities arising to build positions in quality companies at attractive prices. As seen after the GFC, substantial returns are on offer when companies can transition from fears of declining growth or short-term earnings risk, back to a profile that the market is prepared to construe as sustainable steady growth.

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